No. 79-584

IN THE

Supreme Court of the United States

OCTOBER TERM, 1979

RESEARCH EQUITY FUND, INC.,
Petitioner

v.

THE INSURANCE COMPANY OF NORTH AMERICA,
Respondent

On Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit

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SUPPLEMENTAL BRIEF FOR PETITIONER

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Pursuant to Rule 24(5) of the Rules of this Court, this supplemental brief addresses the brief *amicus curiae* of the United States, filed on February 29, 1980, in response to the Court's order of January 7, 1980, inviting the Solicitor General to file a brief expressing the views of the United States in this case.

1. While agreeing that the decision of the court of appeals is in error and that the case is important, the government in its *amicus* brief suggests that review

may not be "essential" because the Securities and Exchange Commission is considering whether to promulgate new regulations interpreting Section 17(g) of the Act and, in effect, overruling the decision in this case.

The government's position assumes that the decision interprets the existing Commission regulations under Section 17(g), rather than the statute itself. That is a view we do not share. The opinion of the court of appeals rests quite clearly on statutory interpretation: it discusses what Congress intended in Section 17(g) and it holds that Congress did not intend to have bonding coverage extended to mutual fund portfolio managers supplied by investment advisers because they are not Section 17(g) "employees."[1] At one point at least, the Commission itself thus viewed the opinion. In its *amicus* submission on petition for rehearing, it told the court of appeals that the court's result was "anomalous" and one that "*Congress* could hardly have intended"—a statement the government quotes in its *amicus* brief in this Court.[2]

While the government suggests that the Commission has rulemaking authority under Section 38 of the Act (15 U.S.C. 80a-37(a)) to define the term "employee," any court considering such regulation would refer back to Section 17(g) to determine the scope of

[1] See, *e.g.*, Pet. App. 10a ("*Congress* obviously contemplated the bonding requirement would be applicable only to those persons who are in part officers or employees of the mutual fund"); *id.* at 10a ("Since the *statute* does not require coverage for the losses suffered by WGF at the hands of someone such as Sanders . . . .").

[2] Brief for the United States as *Amicus Curiae*, at p. 4.

the Commission's powers, as the court did in *SEC* v. *Talley Industries, Inc.*, 399 F.2d 396, 404 (2d Cir. 1968), *cert. denied*, 393 U.S. 1015. If the opinion of the court below prevails, the regulations would be struck down. The Commission's rulemaking authority may be considerable, as the government says, but it cannot overrule a federal appellate court's interpretation of a statute.[3] That is the function of this Court when an important case has been wrongly decided.[4]

2. Furthermore, even if the Commission does engage in rulemaking (and there is no assurance by the government whether or when it will) and even if other courts eventually uphold the new rules,[5] this would hardly cure the problem created by the court of appeals decision in this case. Regulations are not retroactive. Unless that decision is reversed, investors in mutual funds that have bonds like petitioner's will have been stripped of bonding protection for losses suffered in the past through the dishonesty of portfolio managers. (Fidelity bonds are "discovery" bonds,

[3] See, *e.g.*, *Ernst & Ernst* v. *Hochfelder*, 425 U.S. 185, 213 (1976) ("The rulemaking power granted to a federal agency charged with the administration of a federal statute is not the power to make law.").

[4] If this Court upheld petitioner's and the Commission's interpretation of Section 17(g), the Commission would of course be free to implement that interpretation through further regulations if it thought these necessary or desirable.

[5] We have noted before that "This is peculiarly an area in which a definite and uniform rule should prevail. Only then can the cost of protecting investors against dishonesty by fund managers be spread equitably throughout the mutual fund industry and only then can insurers and mutual funds be certain of the coverage that, at a minimum, must be maintained for the protection of investors." Pet. 13-14.

which provide protection from the point the fraud is discovered.) This is why the Investment Company Institute, as *amicus curiae,* has informed the Court that the decision here adversely affects the 7 million shareholders of the mutual funds it represents.[6]

CONCLUSION

Review by this Court is essential and the petition for a writ of certiorari should be granted.

Respectfully submitted,

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March 1980.

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[6] Brief of the Investment Company Institute, *Amicus Curiae,* at pp. 2, 5.